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Submitted via: Gas Industry Company website

Dear Ian

MPOC Change Request Submission on GIC Draft MBB Recommendation

Genesis Energy strongly disagrees with the GIC draft recommendation to approve the MBB change¹ to the Maui Pipeline Operating Code (MPOC).

We consider Covec's cost benefit analysis ("CBA") significantly underestimates the cost of changing to MBB. In particular the CBA fails to account the market cost of providing a more liquid balancing market, fails to quantify the non-financial costs created by the change, and does not accurately reflect the full financial costs that shippers are likely to bear.

Given these significant omissions in the CBA, Genesis Energy asks that the GIC reconsider its draft recommendation and **reject** the MBB change.

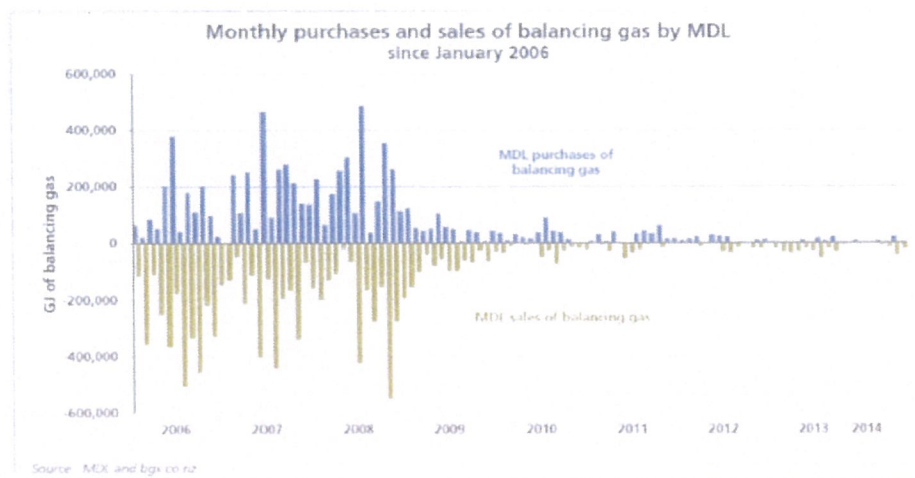
Costs of providing balancing gas are significant

The required gas balancing volume will increase significantly over what is seen in the graph in section 1.1 of the CBA (reproduced in Figure 1 below). The volume of balancing gas required with daily cash outs under MBB will increase from the current level due to reduced tolerances (over time) and the shortening of the length of time to correct imbalances from up to 72 hours down to on the day. In

¹ Draft decision dated 25 February 2015 on the 10 October 2014 Maui Pipeline Operating Code change request

other words, some of the volume that is corrected in Day 1 and corrected in Day 2 in the graph in Figure 2 below will become cashed out under MBB.

Figure 1. Monthly Purchases and Sales of Balancing Gas



The CBA acknowledges that primary balancing will not improve materially without shippers having the incentive and ability to better manage balancing positions. The MBB may create an incentive to better manage positions, but in the case of Genesis Energy (and we suspect the majority of other shippers, the majority of the time) there is no ability to improve on the day primary balancing over what is already done without incurring additional cost. This limit is caused by:

1. The lack of information regarding load that is not linked to SCADA type real time data feeds
2. The time between nomination cycles and cash-out times under MBB.
3. Nomination timeframes and other limits in gas supply agreements.

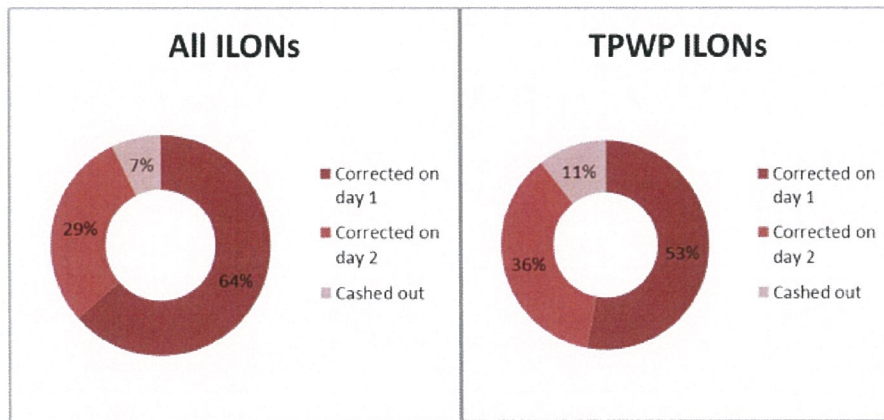
The CBA agrees that shippers do not have complete information on their physical positions on any given day (2.2.1).

Figure 1 in section 2.2.1 of the CBA (reproduced below) helpfully explains that shippers have the ability to react to ILONs on the days following an ILON notice, not that primary balancing can be improved on the day. The ability for shippers to react to ILONs on the days following an ILON is possible because the restrictions listed in 1 to 3 above are reduced during the 72 hour (maximum) timeframe available under the current ILON process to rectify imbalances.

In summary it is likely that gas balancing volume will increase significantly over what is seen in the graph in section 1.1 of the CBA. The cost of providing this additional balancing gas volume is not considered in the CBA.

Figure 2. ILON Responses

Figure 1: ILON Responses in 2014 (Source: MDL)



For there to be a liquid gas balancing market as contemplated by the CBA, there must be sufficient volumes to be bid and offered, and any gas offered on the balancing market will be in addition to the volume required to meet contracted sales. The volume of gas required for physical sales is mutually exclusive from the volume of gas required for balancing. There is a good analogy in the electricity market: the volume of electricity offered for dispatch in the electricity market is mutually exclusive of the volume of electricity offered for electricity reserves. They cannot be offered into both markets at once. If an electricity generator wants to reduce its exposure to the reserves market then it cannot sell its entire generation capacity.

This means gas shippers will either need to contract for more gas supply, or sell less gas (less gas demand) under MBB in order to supply gas to the balancing market. Increased liquidity in the balancing market under MBB, which is the cornerstone of the CBA will not occur without additional volume being offered into the balancing market.

Example

If a gas wholesaler had a gas supply contract of 100TJ/day and a gas sales contract of 100TJ/day, then that gas wholesaler would have no additional gas to offer on the balancing market (and therefore contribute no liquidity to the balancing market). However, under MBB, the wholesaler is incentivised to manage their daily position via the balancing market – else they bear the risk of cash-out penalties caused by volume uncertainty. For the gas wholesaler to offer 5TJ of gas on the balancing market then they would need a gas contract capable of supplying 105TJ.

Potential significant cost of balancing gas

The CBA does not attempt to quantify the cost of shippers providing additional gas for the balancing market. But in our view, the cost is likely to be significant. In the example above, the party may need to access 10TJ of additional gas processing capacity, 5% more gas contract capacity – and if there is an annual take-or-pay gas contract, likely 5% more gas take or pay. Alternatively the wholesaler may opt to sell 5TJ less gas.

If a party was to accept 5TJ/day less gas sales in order to supply 5TJ of gas into the balancing market and that gas sale would have been at a price of \$6/GJ, then the loss of sales revenue would be \$11million per year. This far exceeds the \$1million benefit from MBB in the CBA. This cost being ignored in the CBA is akin to assuming the gas balancer has a free option to buy and sell gas, which is not reality.

The level of balancing gas required by a shipper will vary depending upon the shipper's individual circumstances. Some shippers may choose to purchase additional gas (at an increasing price if balancing gas is scarce), and some will choose to change their demand profile. But at a market level, even a relatively minor demand contraction of 0.5TJ/day will reduce revenue for the market - eclipsing the \$1 million benefit identified by the CBA.

Non-financial costs need to be quantified

Section 2.2.1 Economic commentary states:

“Since shippers will be bearing some extra financial risk, it would not be surprising if end-user contracts reflected these costs. Such changes could be reflected through higher average prices or perhaps the addition of extra tariff steps that depend on the peaking characteristics of a customer's load, or both.”

We agree. However, with the exception of the above statement, the consumer cost of the MBB proposal is ignored in the remainder of the CBA. In our view, any dead weight loss, induced by a price increase to end consumers, must be reflected in the CBA.

There are a number of additional costs not contemplated by the CBA.

Other missing financial cost components

- **System upgrade costs:** Our internal financial assessment shows that MBB will introduce at least \$200,000 one off system upgrade for Genesis Energy and \$30,000 per annum for on-going maintenance. Other shippers are likely to face similar costs, equating to a financial cost to the industry in excess of the CBA cost figure (suggested at only \$150,000 per annum).
- **Brokerage costs:** Brokerage costs are \$0.125/GJ for the buyer and seller (\$0.25/GJ in total) when gas is transacted on emsTradepoint for small participants. - approximately \$60k per annum for Genesis Energy.
- **0.5 additional full time employee (FTE):** An additional 0.5 FTE will be required for offering balancing volume, load forecasting and working during contemplated later nomination cycle times. - approximately \$50k per annum for Genesis Energy.
- **TOU data cost:** Approximately 200 TOU metered sites don't have SCADA data feeds. Additional data download costs of approximately \$4 per 200 sites per day across the industry or \$292k per annum. For Genesis Energy this cost will be approximately \$107k per annum.

Total other missing costs add to a one off cost of \$200k and an ongoing cost of \$247k per annum.

Recommendation: Amend CBA and reject proposed change

The Covec CBA must be amended to incorporate the significant costs of the MBB change discussed above. In particular, we consider the omission of dead-weight costs to consumers particularly concerning – given the level of industry scrutiny on this proposal.

In our view, this amendment should lead the GIC to the view that the proposed MBB change cannot go ahead in its current form. Give that the GIC has no ability to amend the change proposal, we ask that the GIC **reject** the change in its entirety.

If you have any questions with this submission please contact Duncan Jarrod on 09 951 9145 or Daisy Shen on 04 495 6357.

Yours Sincerely,

A handwritten signature in blue ink, consisting of a large, stylized 'A' followed by a long horizontal stroke.

Albert Brantley
Chief Executive